

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Gray Davis, Governor

July 30, 2001

Mr. David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: Reliant Energy Services, Inc., Reliant Energy Coolwater, LLC, Reliant Energy Ellwood, LLC, Reliant Energy Etiwanda, LLC, Reliant Energy Mandalay, LLC and Reliant Energy Ormond Beach, LLC

Docket Nos. ER99-1801-005, ER99-2082-002, ER99-2081-002, ER99-2083-002, ER99-2080-002 and ER99-2079-002

Dear Mr. Boergers:

The California Electricity Oversight Board hereby submits an electronic filing of its Motion to Intervene and Protest in the above-referenced dockets.

Thank you for your assistance.

Sincerely,

/s/ Lisa V. Wolfe

Lisa V. Wolfe
Staff Counsel
Electricity Oversight Board

Enclosures

cc: Official Service Lists of ER99-1801, ER99-2082, ER99-2081, ER99-2083, ER99-2080 and ER99-2079

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Reliant Energy Services, Inc.
Reliant Energy Coolwater, LLC
Reliant Energy Ellwood, LLC
Reliant Energy Etiwanda, LLC
Reliant Energy Mandalay, LLC
Reliant Energy Ormond Beach, LLC

Docket Nos. ER99-1801-005
ER99-2082-002
ER99-2081-002
ER99-2083-002
ER99-2080-002
ER99-2079-002

**MOTION TO INTERVENE AND PROTEST OF THE
CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to the Federal Energy Regulatory Commission's ("Commission" or "FERC") Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and 385.214(a)(3) and (b), the Commission's Notice of Filing dated June 20, 2001, and the Commission's Notice of Extension of Time dated June 27, 2001, the California Electricity Oversight Board ("Board") hereby moves to intervene and protests in the above-captioned proceedings.

I. CORRESPONDENCE AND COMMUNICATIONS

The principal office of the Board is located at 770 L Street, Suite 1250, Sacramento, California, 95814. All pleadings, orders, correspondence and communications regarding this motion should be directed to the following persons:

Erik Saltmarsh, Chief Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: (916) 322-8601
Fax: (916) 322-8591
ens@eob.ca.gov

Lisa V. Wolfe, Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: (916) 322-8601
Fax: (916) 322-8591
lwolfe@eob.ca.gov

II. MOTION TO INTERVENE

Pursuant to the Commission's Notice of Filing dated June 20, 2001 and Notice of Extension of Time dated June 27, 2001, the Board moves to intervene to obtain party status to represent itself, and the responsibilities the State of California has assigned to it, in the above-captioned proceedings. The Board was created as a component of California's comprehensive restructuring legislation. The Board's statutory responsibilities include oversight of the California Independent System Operator Corporation ("CAISO") including the energy and ancillary services markets administered by the CAISO and the reliability of the California electric grid.

On June 15, 2001, Reliant Energy Services, Inc. ("RES"), Reliant Energy Coolwater, LLC, Reliant Energy Ellwood, LLC, Reliant Energy Etiwanda, LLC, Reliant Energy Mandalay, LLC, and Reliant Energy Ormond Beach, LLC (collectively, the "Reliant Energy California Companies" and, together with RES, the "Reliant Energy Companies") filed with the Commission an updated market power study. The Reliant Energy California Companies own generation facilities in California totaling about 3,776 MW of capacity. RES is a power marketer with authority to sell wholesale electric power and ancillary services at market-based rates. The Reliant Energy Companies' triennial market power update is submitted in compliance with Commission orders initially granting the Reliant Energy Companies authorization to sell energy and capacity at market-based rates.¹

In light of the uncompetitive conditions plaguing California's wholesale electric markets, indelibly characterized by the rampant exercise of market power by public

utility sellers such as the Reliant Energy Companies, the Board is acutely concerned about Commission grants or renewal of market-based rate authority for sales of energy and capacity in California. As a result of the Board's statutory responsibilities described above, and on behalf of California consumers, the Board has an interest that may be directly affected by the outcome of the above-captioned proceeding and the Board's participation is in the public interest of the citizens of the State of California. 18 C.F.R. §§ 385.214(b)(2)(ii) and 385.214(b)(2)(iii). Based on the foregoing, the Board respectfully requests that the Commission grant this motion to intervene.

III. PROTEST

A. California's Wholesale Energy Markets are Uncompetitive and the Reliant Companies Have Exercised and Have the Potential to Continue to Exercise Market Power in California Resulting in Unjust and Unreasonable Rates

Public utility sellers are not entitled to market-based rate authority as a matter of right. On the contrary, Courts permit the Commission to exercise its authority under Sections 205 and 206 of the Federal Power Act to permit market-based rates only to the extent that the Commission can ensure resulting prices are just and reasonable. *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) ("*Farmers Union*"). Further, in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993), the Court authorized the Commission to "rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result" only "when there is a competitive market."

The Commission's general standard for granting of market-based rate authority is to allow power sales at market-based rates if the seller and its affiliates do not have, or

¹ See *Ormond Beach Power Generation, L.L.C.*, 83 FERC ¶ 61,306 (1998); *Ocean Vista Power Generation, L.L.C., et al.*, 82 FERC 61,114 (1998); *NorAm Energy Services, Inc.*, Letter Order, Docket No.

have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry. *Pacific Gas & Electric Company*, 77 FERC ¶ 61,265, p. 62,083 (1996); *AES Southland, Inc.*, 94 FERC ¶ 61,248 (2001).

Consistent with case law and Commission standards, the Commission must revoke the Reliant Energy Companies' market-based rate authority. California's wholesale energy markets are not competitive, and, more specifically, the Reliant Energy Companies have exercised market power (and have the potential to continue to do so) resulting in unjust and unreasonable rates.

As the Commission has held on numerous occasions over the last nine months, the California markets are dysfunctional and there is "clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight, ... can result in unjust and unreasonable rates under the FPA [and] have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy." *San Diego Gas & Electric Company*, 93 FERC ¶ 61, 294 (2000), slip op. at 8.

Further, the abuse of market power by Reliant Energy Companies (and other public utility sellers in California's energy markets) is not mere conjecture. Numerous reports have been filed with the Commission that provide substantial evidence of the exercise of market power by public utility sellers, including the Reliant Energy Companies, in California's energy markets.² These reports provide direct evidence that

ER94-1247-000 (July 25, 1994).

² See e.g. "Empirical Evidence of Strategic Bidding in California ISO Real Time Markets" (CAISO Report) submitted by the CAISO as attachment C in its June 7, 2001 "Emergency Motion of the California Independent System Operator Corporation for Termination of Market-Based Rate Authority, to Institute Further Proceedings, and Motion to Consolidate" ("Emergency Motion") in Docket Nos. ER98-927-000 et al. See also the CAISO April 9, 2001 report entitled "Impacts of Market Power in California's Wholesale Energy Market: More Detailed Analysis Based on Individual Seller Schedules and Transactions in the ISO

many large suppliers, the Reliant Energy Companies included, have actively engaged in bidding practices consistent with oligopolistic pricing behavior, with a direct and substantial impact on market prices.

The Board acknowledges that the Commission has taken steps in an ongoing attempt to restore order to western wholesale energy markets; the most recent such order was issued June 19, 2001³ and provides a plan for price mitigation in all hours and across the western region. However, Commission issuance of this latest order cannot justify continued grant of market-based rate authority to sellers in California's wholesale energy markets who have already exercised and may continue to exercise market power.

First, the mitigation mechanism articulated in the June 19 order terminates after one year, regardless of market conditions at that time. Second, the actual effectiveness of this order in disciplining prices has yet to be determined. California has been entangled in a successive string of Commission orders since December 2000 that have been ineffective in ensuring workably competitive conditions and securing just and reasonable rates. "Without empirical proof" that the market will constrain rates to levels that are just and reasonable (*Farmers Union*, 734 F.2d 1510 (D.C. Cir. 1984)), and without "substantial evidence upon the basis of which the Commission could conclude that market forces will keep...prices in check" (*Texas Power Corp v. FERC*, 905 F.2d 1005 (D.C. Cir. 1990)), the Commission may not, as a matter of law, permit the continuation of market-based rates.

and PX Markets" appended as Attachment D in the Emergency Motion. On June 7, 2001, the CEOB filed a Motion To Intervene Out-of-Time and Comments in Support of the Emergency Motion. The Board herein reiterates its support of the Emergency Motion.

³ "Order on Rehearing of Monitoring and Mitigation Plan for the California Wholesale Electric Markets, Establishing West-Wide Mitigation, and Establishing Settlement Conference" issued June 19, 2001 in Docket Nos. EL00-95-031 et al.

B. The Commission Methodology for Analysis of Market Power is Ineffective for California

The Commission's traditional test for the ability of a market participant to exercise market power, hub-and-spoke analysis and an overall time-averaged 20% market share threshold for concern,⁴ is entirely ineffective for determining the exercise of market power in California's markets. This outdated simplistic methodology cannot account for the dynamics at work in California's energy markets. California's energy and, particularly, ancillary services markets function as a series of time-segregated markets. Overall time-averaged market share does not and cannot adequately predict the ability of a market participant in California's markets to exercise market power on a recurring basis in certain time periods, e.g. periods of peak demand. The Board is among numerous parties (including the CAISO and the California Public Utilities Commission) that have expressed concern about the hub-and-spoke/market share methodology to the Commission as long ago as 1998.⁵ Certainly, the tumultuous events in California's energy markets marked by the exercise of market power by public utility sellers testify to the ongoing validity of this concern expressed to the Commission three years ago.

FERC Commissioners themselves recognize that the traditional hub-and-spoke/market share analytic standard is inappropriate to assess market power for the purpose of granting market-based rates. Commissioner Massey, in his dissenting opinion in Sierra Pacific Power Company, 95 FERC ¶ 61,059 (2001), states: "... the Commission continues to rely on an outdated and unreliable analytic standard to assess market power

⁴ See e.g., Louisiana Energy and Power Authority v. FERC, 141 F.3d 364 (D.C. Cir. 1998).

⁵ See e.g., "Motion to Intervene and Preliminary Comments and Answer of the California Electricity Oversight Board in Support of the Emergency Motion for Stay, Request for Rehearing, and Motion for Clarification of the California Independent System Operator Corporation", Docket Nos. ER98-2843-001 et al., and "Motion to Submit Out-of-Time Comments and Protest of the Public Utilities Commission of the State of California", Docket No. ER98-4498.

for the purpose of granting market-based rates ... Because this analytic method is so unreliable, the Commission has no basis upon which to make a reasoned determination whether the marketer will be able to exercise market power ... little or no account is taken of the important factors that determine the true scope of electricity markets, such as physical limitations on market size including transmission constraints, prices, costs, transmission rates, and the variance of supply and demand over time. Virtually no seller ever fails this screen, and thus it is no screen at all” (Massey, dissenting at 1).⁶

Commissioner Massey recommends analyzing market power for the purpose of granting market-based rate authority under a four-pronged approach. First, market concentration would be assessed using a more sophisticated approach (i.e., the Appendix A delivered price test for mergers⁷) that considers energy prices, transmission capacity, transmission prices, and the time dimension of supply and demand (i.e., measure of supplier concentration at various load levels such as peak, super peak, off peak, and shoulder). Second, the market design elements needed for competitive markets must be in place. Third, adequate demand responsiveness must exist. Fourth, past behavior in the market (e.g., past instances of successful withholding in the market) that could be a clue to flaws in the market undetected by other elements of the analysis must be considered.

⁶ Although, the concurrence of Commissioners Wood and Brownell in the Sierra Pacific case has not been published as of the time of this writing, press reports of the July 11, 2001 Commission meeting indicate that Commissioners Wood and Brownell share Commissioner Massey’s concern with the outdated hub-and-spoke methodology.

⁷ Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Statutes and Regulations ¶ 31,044 (1996), reconsideration denied, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement).

The Board applauds this recommendation as it is on track to address the concerns articulated by the Board and other parties.⁸

The Commission should act immediately to replace the current outdated market power analysis methodology with a more sophisticated approach that accounts for the complex realities inherent in California's energy markets. Continued Commission use of an outdated and ineffective market power analysis methodology is tantamount to a Commission rubberstamp of sellers into California markets armed with the potential to exercise market power and exact unjust and unreasonable rates.

IV. CONCLUSION

Based on the foregoing, the Board respectfully requests that the Commission revoke the Reliant Energy Companies' market-based rate authority, require the Reliant Energy Companies to file cost-of-service tariffs, subject to refund, and set this matter for hearing to determine appropriate cost-based rates.

Dated: July 30, 2001

Respectfully submitted,

/s/ Lisa V. Wolfe

Lisa V. Wolfe
Staff Counsel
Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
(916) 322-8601

⁸ Although, the Board may not necessarily agree with all of Commissioner Massey's recommended market design elements, the Board certainly agrees in general principle that effective market design is a crucial characteristic of workably competitive energy markets. Likewise, the Appendix A approach may or may not ultimately be the best approach to consider market concentration, but does exemplify an approach that takes into account critical aspects of California wholesale electric markets, particularly time differentiation.

CERTIFICATE OF SERVICE

I hereby certify that, on July 30, 2001, I served the foregoing document upon each person designated on the official service lists compiled by the Secretary for this proceeding.

Dated at Sacramento, California, this 30th day of July 2001.

/s/ Lawrence Cook

Lawrence Cook
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
(916) 322-8601